

Internal Revenue Service

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Person To Contact:

, ID No.

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PLR-141747-06

Date: March 21, 2007

LEGEND

X =

H1 =

W1 =

Trust1 =

H2 =

W2 =

Trust2 =

B =

Trust3 =

I =

D1 =

D2 =

State =

Dear :

This responds to a letter dated August 31, 2006, and subsequent correspondence submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State. X elected to be treated as an S corporation for federal tax purposes, effective D1. On D1, shares of X stock were transferred to Trust1, Trust2, and Trust3. Trust1 and Trust2 are grantor trusts and eligible S corporation shareholders under § 1361(c)(2)(A)(i). Trust3 intended to meet the requirements of a Qualified Subchapter S Trust (QSST). However, due to miscommunication on the part of its professional advisors, the QSST election was not filed on behalf of Trust3.

Upon a review of the tax returns for the shareholders in D2, a tax advisor discovered that a QSST election had not been filed for Trust3 and therefore, Trust3 was an ineligible shareholder. X represents that Trust3 meets the requirements of a QSST.

H1 and H2 signed Form 2553, Election by a Small Business Corporation, in their capacity as grantors and owners for Trust1 and Trust2, respectively. B and I signed the election in their capacity as Trustees for Trust3. W1 and W2 have community property interests in Trust1 and Trust2, but they failed to sign the Form 2553.

X represents that the failure to have all eligible shareholders consent to the S corporation election and the failure to file a QSST election were inadvertent and not motivated by tax avoidance or retroactive tax planning. X and X's shareholders represent that, despite the failure to provide all the consents necessary for the S corporation election, X and X's shareholders have filed their federal income tax returns consistent with the treatment of X as an S corporation. B, as the sole beneficiary of Trust3, represents that she has been treated as the owner of Trust3 since D1 and has reported all income, gain, or loss attributed to the X stock since D1.

X and X's shareholders, Trust1, Trust2, and Trust3, the owners of the trusts, H1, H2, W1, W2, and B have agreed to make any adjustments that the Commissioner may require

consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(b)(1) defines the term "small business corporation" to mean a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a)(1) provides that a small business corporation may elect to be an S corporation.

Section 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(2)(iv) of the Income Tax Regulations provides that in the case of a trust described in § 1361(c)(2)(A) (including a trust treated under § 1361(d)(1)(A) as a trust described in § 1361(c)(2)(A)(i) and excepting an electing small business trust described in § 1361(c)(2)(A)(v) (ESBT)), only the person treated as the shareholder for purposes of § 1361(b)(1) must consent to the election. When stock of the corporation is held by a trust, both husband and wife must consent to any election if the husband and wife have a community interest in the trust property.

Section 1362(b)(1) provides that an election under § 1362(a) is effective for the current taxable year if it is made during the preceding taxable year or on or before the 15th day of the third month of the current taxable year.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) -- (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made. Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of the QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(f) provides that, if: (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b), or (B) was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the corporation is once more a small business corporation; and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's intended S corporation election was ineffective because the election did not contain consents from W1 and W2 to X's S corporation election. In addition, X's election was not effective because Trust3 was an ineligible shareholder due to the failure to make a QSST election for Trust3. We conclude that the ineffectiveness was inadvertent within the meaning of § 1362(f).

Under § 1362(f), X will be treated as an S corporation from D1 and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d). All shareholders of X, in determining their respective income tax liabilities, must include their pro rata share of separately and nonseparately computed items of X as provided in § 1366, make adjustments to stock basis as provided in § 1367, and take into account any distributions by X as provided by § 1368.

This ruling is conditioned on X making an election to be an S corporation by filing with the appropriate service center a new completed Form 2553 that contains the proper consents of all of X's shareholders with an effective date of D1, within 60 days following the date of this letter.

As a further condition, a QSST election for Trust3 with an effective date of D1 must be filed with the appropriate service center within 60 days from the date of this letter. A copy of this letter should be attached to the new Form 2553 and QSST election. This ruling will be null and void if these conditions are not satisfied.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation or the eligibility of Trust1, Trust2 or Trust3 to be S corporation shareholders.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

/s/

James A. Quinn
Senior Technician Reviewer (Acting)
Branch 2
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes